No. 11,098

United States Circuit Court of Appeals

For the Ninth Circuit

STELLA WHEELER BISHOP, *Petitioner,* vs. COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	

Petitioner's Reply Brief

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ANALYSIS OF RESPONDENT'S ARGUMENT

The burden of Respondent's argument is stated in the following excerpt from his brief (p. 19):

> "We agree with the taxpayer's fundamental premise that 'ownership' is the ultimate consideration in determining taxability (Br. 11, et seq.); it is submitted, however, that the taxpayer mistakenly identifies ownership with legal title. All the important indicia of ownership, i.e. possession, control and the right to income, exist in the executors or administrators during administration. Regardless of where legal title exists, ownership lies in the estate during administration."

NOTE: Italics used in this brief are ours except where otherwise noted.

Respondent's concession that the ownership of property determines who shall deduct a loss sustained on its sale is coupled with the admission, implicit not only in the above quotation, but also in his entire argument, that the wife retains title to her one-half of the community property acquired after 1927, pending administration of her husband's estate. Respondent thus narrows his case down to a single proposition, that the powers of the husband's personal representative over the wife's one-half of the property are such that substantial ownership of it, as contrasted with title to it, must be held to be vested in the personal representative.

To sustain this proposition, it would seem to be necessary to establish that the powers of the husband's personal representative over the wife's half of the property are greater than the powers that were possessed by the husband, because admittedly the husband was not the owner of the wife's half while he was alive, notwithstanding the broad powers possessed by him (*Malcolm v. U. S.* (1931), 282 U.S. 792; *U. S. v. Goodyear* (C.C.A. 9, 1938), 99 F.(2d) 523).

Section 172 of the California Civil Code provides that "The husband has the management and control of the community personal property, *with like absolute power of disposition, other than testamentary, as he has of his separate estate,* provided, however, that he cannot make a gift of such community personal property * * *"* etc. This section gave the husband almost unlimited power over the wife's half of the community personal property; he could

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*These powers are expressly reserved to him by Civil Code, Section 161a.

sell it; he could invest and reinvest it; he could encumber it; in short, he could do anything he pleased with it except to give it away without the wife's consent. Nevertheless, he was not the owner of it.

How do the husband's powers compare with those of the husband's personal representative?

The husband's personal representative has the right to possession of the property. *Parsley v. Superior Court* (1940), 40 Cal. App.(2d) 446, 104 P.2d 1073. The husband had the same right.

If the property consisted of cash, the husband's personal representative could use it to pay debts (§202 Cal. Probate Code). Again, the husband had the same right.

Should the husband's personal representative need to sell the property to pay debts, he could do so, but not without the confirmation of the probate court, if the property was real property, or without a previous order of the court, if the property consisted of securities (§§755, 771, Cal. Probate Code).

These are the sole powers possessed by the husband's personal representative. They are insignificant compared with the powers possessed by the husband during his life, and they fall far short of Respondent's characterization of them as "All the important indicia of ownership, i.e., possession, control, and the right to income" (R. Brief, p. 19). Respondent states that Petitioner has confused ownership with legal title. The truth of the matter seems to be that Respondent has confused ownership with possession.

What actually happens on the husband's death is that the majority of the husband's powers (and all those involving discretionary control) are swept away, being replaced by the much more limited powers of his personal representative.

It must be concluded, we submit, that the powers of the husband's personal representative are not greater than the husband's, but on the contrary are far more limited. If the husband's broad powers were not sufficient to make him the owner of the wife's half of the property, then it is inconceivable that his personal representative, with much more limited powers, could be the owner of it. The loss of the husband's powers occasioned by his death can only operate to make the wife's ownership absolute; by no process of reasoning can the elimination of these powers be deemed to occasion a shift of ownership from the wife to the husband's executor or administrator.

So much for the argument that the husband's personal representative has "all the indicia of ownership". Respondent's remaining arguments have no more validity than this one.

Respondent makes much of the powers of the probate court over the wife's half of the community property acquired after 1927 (R. Brief, pp. 9-13). The jurisdiction of the probate court seems to us to have little relevancy in determining whether the wife or the husband's personal representative is the owner of her half of the property. In any event, however, the probate court's powers are in fact very limited. It can confirm sales of real property; and it can authorize sales of securities (Cal. Probate Code, §§755 and 771). If any contest should arise, it can determine what is community property and what is separate. The husband, however, had unlimited authority to sell community property (Cal. Civ. Code, §172); and should a dispute have arisen during the lifetime of the parties, the courts would have had jurisdiction to determine what was community property and what was separate (*Milekovich v. Quinn* (1919), 40 C.A. 537, 181 Pac. 256). We are unable to see, therefore, how the powers possessed by the probate court add anything to Respondent's argument.

Finally, Respondent relies heavily upon Probate Code, Section 581, which provides that "The executor or administrator is entitled to the possession of all the real and personal property of the decedent and to receive the rents, issues and profits thereof until the estate is settled or until delivered over by order of the court to the heirs, devisees or legatees."

Passing by the question whether this section applies to the wife's half of the community property, which is *her* property under Civil Code §161(a), and not the decedent's, we wish to point out that in this instance, as indeed throughout the Respondent's brief, his argument is that all the *income* from community property acquired after 1927 is taxable to the husband's estate. Respondent has consistently subordinated the real issue in the case, whether one-half of a *loss* sustained upon the sale of such property is deductible by the wife, or whether the entire loss must be deducted by the husband's estate.

This point is of particular importance because it can not be disputed that the owner of property is the only one who sustains a loss on its sale; nor can it logically be denied that after the husband's death the wife continues to be the owner of her half of the community property acquired after 1927. Regardless of whether the husband's personal representative has enough control over the *income* from the wife's half of the community property acquired after 1927 to constitute him the owner of such income, which is a separate and distinct question from that involved here, it is apparent that he does not have such control over the *property itself*. Respondent contends that it would be anomalous to tax all the income from such property to the estate, but to allow the wife to deduct one-half the loss from the sale of the property. The anomaly, if any, arises out of Respondent's assumption that all the income from community property acquired after 1927 is taxable to the estate. It may be, and we think it should be, taxable one-half to the wife. However, the question has never been decided by the courts and is not involved here.

THE ROSENBERG, LARSON, AND BARBOUR CASES

Respondent contends that the present case is indistinguishable from *Rosenberg v. Commissioner* (C.C.A. 9th, 1940), 115 F.(2d) 910; *Commissioner v. Larson* (C.C.A. 9th, 1943), 131 F.(2d) 85; and *Estate of Barbour v. Commissioner* (C.C.A. 5th, 1937), 89 F.(2d) 474; and that these cases are controlling.

In the *Rosenberg* case, this court made it plain that it was dealing solely with community property acquired prior to 1927; the case does not purport to decide the issue involved in this case, which relates solely to community property acquired after 1927. In the *Rosenberg* case the court held that community property acquired prior to 1927 retains the same tax status after the husband's death as it had before. We contend, similarly, that post-1927 community property retains the same tax status after the husband's death as it had before. Certainly Respondent has pointed to nothing that could logically be deemed to cause a transfer of ownership of the wife's one-half to her husband's executor or administrator.

Respondent attempts to show that the *Larson* case was not decided on the basis that title to Washington community property passes to the executor; he argues that part of the income involved there consisted of rent, and that title to the community real property does not pass to the executor. Respondent overlooks the following observation made by this court in the *Larson* case: "Pierce's Code, 1933, §9863, provides that title to realty vests immediately in the heirs or devisees who are entitled to the rents, issues and profits thereof as against 'any person *except the executor or administrator* and those lawfully claiming under such executor or administrator'." Thus it is apparent that as between the executor or administrator and the surviving wife, the husband's executor or administrator in Washington has title to realty, as well as to personalty.

In the *Barbour* case the Circuit Court of Appeals for the Fifth Circuit, reversing The Tax Court, held that all income from Texas community property was taxable to a deceased husband's estate pending its administration, and that none of such income was taxable to the widow.

The *Barbour* case is not in point because under the laws of Texas in effect at the time of the husband's death, the husband's executor became statutory trustee of *all* of the community property under Article 3630, Rev. Civ. Stats. of Texas 1925, which provided as follows:

"Article 3630—Property held by Executor. Until such partition is applied for and made, the executor or administrator of the deceased shall recover possession of all such common property *and hold the same in trust for the benefit of the creditors and others entitled thereto.*"

Thus under Texas law the husband's personal representative, by virtue of his trusteeship, became the owner of the entire community property upon the husband's death. No provision of the California law, however, makes the husband's personal representative a trustee of any part of the community property for any purpose.

This distinction between California law and Texas law was recognized in G.C.M. 20472, 1938-2 C.B. 158 (cited in our opening brief), holding the *Barbour* case not to apply under California law. The ruling stated as follows:

"* * * a statute of Texas specifically provides, in addition to provisions similar to those set out above, that community property shall be held in trust for the benefit of creditors. Such a statute would appear to vest title to the property during administration in the administrator or executor. A search of the statutes of California fails to reveal any such provision, and inasmuch as upon death of the husband one-half of the community property 'belongs' to the surviving widow, it would be difficult to apply the concept of a trust".

Finally, the *Rosenberg*, *Larson* and *Barbour* cases all involved *income;* in this case we are dealing with a *loss.* As The Tax Court stated in *Estate of James F. Waters* (1944), 3 T.C. 407 (holding that for the purpose of determining the amount of gain or loss on the sale after the husband's death of the wife's half of community property acquired after 1927, the basis is cost, since the wife remains the owner):

> "Nothing in the *Rosenberg* and *Larson* cases contradicts this holding. In those cases it was held that the ownership of the *income** was in the executor or administrator because of his control over the income. While control of the widow's share of the income may be sufficient to render the estate taxable, certainly it does not evidence such a transfer of ownership as to necessitate assignment of a new basis."
>
> 2 T.C. at 410.

Respondent cites *Robertson v. Burrell* (1895), 110 Cal. 568, 42 Pac. 1086, as holding that in California an executor or administrator is a trustee. A reading of the full opinion in that case, however, discloses that the court meant only that the executor or administrator acts in a fiduciary capacity similar to that of an agent, not that he is a true trustee. It is difficult to see how a trust could exist unless the fiduciary had title, which the executor or administrator admittedly does not.

Respondent argues that the enactment of Civil Code Section 161a only affected the nature of the wife's interest in community property during the husband's lifetime, and did not affect the status of the property after the husbond's death; from this Respondent draws the inference that ownership of the wife's half of community property acquired after 1927 is transferred to the husband's executor or administrator. A sufficient answer to this contention is found in the opinion of Judge Jenney in *Sampson*

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*Italics the Court's.

v. Welch (1930), 23 F.Supp. 271, 40 F.Supp. 1014, aff'd (C.C.A. 9, 1943), 138 Fed.(2d) 417. In the *Sampson* case the court held that the wife's half of community property acquired after 1927 is not includible in the husband's gross estate for estate tax purposes. The court said:

> "It is significant that under section 201, one-half of the community property does not go to the wife upon her husband's death, but belongs to her. So sharp a difference in wording cannot be ignored. *Construing section 201, adopted in 1923, together with section 161a, adopted in 1927, this court must conclude that the Legislature intended that the wife's interest, bestowed upon her by the latter act, should remain in her—should belong to her—without the limitations upon management and control, now removed by the spouse's death, and without passing into or becoming a part of the decedent's estate for any purpose other than as specified in section 202.*
>
> "*The wife's interest under section 161a exists during her husband's lifetime. His death merely lifts the restrictive limitations to which it was subject under sections 172 and 172a, except in so far as section 202 subjects it to his debts. On his death, the property interest belongs to the wife, not to the husband's estate. Consequently, it cannot be included in his gross estate in computing estate taxes.*" (23 F.Supp. 281)

Finally, we wish to point out that there is a fundamental inconsistency between the Commissioner's position in this case, and his position in regard to the tax basis to be used in determining the amount of gain or loss on a sale of community property acquired after 1927, made after the husband's death. Furthermore, the same inconsistency exists between the decision of The Tax Court in this case and its decision in *Estate of James F. Waters v. Commissioner* (1944), 3 T.C. 407, Acquiesced I.R.B. 1944-15-11814.

Section 113(a)(5) of the Internal Revenue Code prescribes the tax basis (i.e. the amount to be deducted from the selling price) for determining gain or loss on the sale of property acquired by a decedent's estate from the decedent. It provides in part as follows:

> "(5) Property Transmitted at Death.—If the property was acquired * * * by the decedent's estate from the decedent, the basis shall be the fair market value of such property at the time of such acquisition."

The Commissioner has ruled in G.C.M. 24292, I.R.B. 1944, No. 15, p. 5, that when community property acquired after 1927 is sold after the husband's death, the basis is not the fair market value of the entire property at the time of the husband's death under §113(a)(5), but that the basis of the wife's half is one-half of the cost of the property to the husband and wife, while the basis of the husband's half is its value at the date of the husband's death. Thus, Respondent concedes in this instance that the wife's half is not acquired by the husband's estate; if it were the basis would be fair market value at the time of the husband's death. Respondent bases this rule on the decision in *Estate of James F. Waters v. Commissioner, supra.* In the *Waters* case both the taxpayer and the Commissioner agreed that the husband's estate was entitled to deduct the entire loss from the sale of community property acquired after 1927, and the only point litigated and decided by the case was the correct basis for computing the amount of the loss. The Tax Court held that the basis of the wife's one-half is one-half the cost to the community, because the wife remains the owner of her one-half after the husband's death; it is not acquired by the husband's estate. The Tax Court said:

"It is significant, however, that under section 201 of the probate code one-half of the community property does not go to the wife upon her husband's death, but belongs to her. She does not take as an heir, legatee, or devisee, *In re Brown's Estate*, 129 Pac.(2d) 713; *but by the plain words of the statute ownership of the property itself remains in the widow at all times.*

"With these considerations in mind, we now turn to section 113(a) of the Internal Revenue Code, wherein it is set forth that the basis of property for the purpose of determining gain or loss shall be its cost, except in certain specified instances. It is on authority of the exception numbered (5) that the Commissioner now seeks to sustain the deficiency. This exception reads as follows:

"'(5) Property Transmitted at Death.—If the property was acquired * * * by the decedent's estate from the decedent, the basis shall be the fair market value of such property at the time of such acquisition * * *'."

"The question thus put is whether the widow's half of the community property 'was acquired by the husband's estate from the decedent'.

"As we have already pointed out, the wife had a present, existing and equal interest in the property with her husband, and upon the death of the husband the wife's share does not pass as a part of his estate, but immediately belongs to her. Thus, it seems clear

> that her property could not be 'acquired by the decedent's estate from the decedent'. Therefore, upon disposition of community property by the administrator of the deceased husband's estate, the proper basis for gain or loss of the widow's undivided one-half share is cost (adjusted) to the community.
>
> "Nothing in the *Rosenberg* and *Larson* cases contradicts this holding. In those cases it was held that the ownership of the *income** was in the executor or administrator because of his control over the income. While control of the widow's share of the income may be sufficient to render the estate taxable, certainly it does not evidence such transfer of ownership as to necessitate assignment of a new basis." (3 T.C. at 409)

The decision of The Tax Court in the *Waters* case, based on the premise that the husband's executor or administrator is not the owner of the wife's half of the community property after the husband's death, cannot be reconciled with its decision in the instant case. Nor can Respondent's acquiescence in the rule of the *Waters* case be reconciled with his position in the instant case. If the wife is considered to remain the owner of her half after the husband's death for the purpose of determining the amount of loss on a sale, then she must be considered to remain the owner for the purpose of deducting the loss.

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*Italics the Court's.

CONCLUSION

We submit that Respondent's concession that the ownership of property determines who shall deduct a loss incurred on its sale disposes of this case. By making this concession Respondent assumes the burden of proving that the husband's estate is the owner of a greater interest in community property acquired after 1927 than was the husband during his lifetime.

The husband was not the owner of the wife's half during his lifetime, notwithstanding his broad powers of control; legal title to the wife's half remains vested in the wife after the husband's death, as Respondent tacitly admits; the wife's half "belongs" to her under Section 201 of the Probate Code; and the powers of the husband's executor or administrator over her half of the property are insignificant compared to the husband's powers. What is left, then, to support the argument that ownership of one-half the property, vested in the wife during the husband's lifetime, is transferred to her husband's executor or administrator pending administration of his estate, and reverts to the wife at the end of that period?

If the sale of the property involved here had been made during the husband's lifetime, petitioner would have been entitled to deduct one-half of the loss sustained, because she was the owner of one-half of the property. Her one-half was not includible in the husband's gross estate for estate tax purposes, because she was the owner of it. When the sale was made, the basis for determining gain or loss on the sale of her half was cost, again because she was the owner of the property. A decision that the wife is not entitled to deduct half the loss because her husband's estate is the owner of the entire property for this purpose, although not for any other, would indeed be an anomaly, and we submit that there is no rational justification for such a decision.

Respectfully submitted,

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